

time after the end of a cost accounting period.

(2) Employee Stock Ownership Plan (ESOP) means:

(i) An employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) of 1986 as a stock bonus plan, or combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock, and

(ii) Any other deferred compensation plan designed to invest primarily in the stock of the contractor's corporation including, but not limited to, plans covered by ERISA.

(3) Fair value means the amount that a seller would reasonably expect to receive in a current arm's length transaction between a willing buyer and a willing seller, other than a forced or liquidation sale.

(b) The following modifications of terms defined elsewhere in this Chapter 99 are applicable to this Standard:

(1) Market value means the current or prevailing price of a stock or other property as indicated by market quotations.

(2) [Reserved]

[57 FR 14153, Apr. 17, 1992, as amended at 73 FR 23964, May 1, 2008]

9904.415-40 Fundamental requirement.

(a) The cost of deferred compensation shall be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee. In the event no obligation is incurred prior to payment, the cost of deferred compensation shall be the amount paid and shall be assigned to the cost accounting period in which the payment is made.

(b) Measurement of deferred compensation costs.

(1) For deferred compensation other than ESOPs, the deferred compensation cost shall be the present value of the future benefits to be paid by the contractor.

(2) For an ESOP, the deferred compensation cost shall be the amount contributed to the ESOP by the contractor.

(c) The cost of each award of deferred compensation shall be considered sepa-

ately for purposes of measurement and assignment of such costs to cost accounting periods. However, if the cost of deferred compensation for the employees covered by a deferred compensation plan can be measured and assigned with reasonable accuracy on a group basis, separate computations for each employee are not required.

[73 FR 23965, May 1, 2008]

9904.415-50 Techniques for application.

(a) The contractor shall be deemed to have incurred an obligation for the cost of deferred compensation when all of the following conditions have been met. However, for awards which require that the employee perform future service in order to receive the benefits, the obligation is deemed to have been incurred as the future service is performed for that part of the award attributable to such future service:

(1) There is a requirement to make the future payment(s) which the contractor cannot unilaterally avoid.

(2) The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor.

(3) The amount of the future payment can be measured with reasonable accuracy.

(4) The recipient of the award is known.

(5) If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur.

(6) For stock options, there must be a reasonable probability that the options ultimately will be exercised.

(b) If any of the conditions in 9904.415-50(a) is not met, the cost of deferred compensation shall be assignable only to the cost accounting period or periods in which the compensation is paid to the employee.

(c) If the cost of deferred compensation can be estimated with reasonable accuracy on a group basis, including consideration of probable forfeitures, such estimate may be used as the basis for measuring and assigning the present value of future benefits.

(d) The following provisions are applicable for plans, other than ESOPs,

that meet the conditions of 9904.415-50(a) and the compensation is to be paid in money.

(1) If the deferred compensation award provides that the amount to be paid shall include the principal of the award plus interest at a rate fixed at the date of award, such interest shall be included in the computation of the amount of the future benefit. If no interest is included in the award, the amount of the future benefit is the amount of the award.

(2) If the deferred compensation award provides for payment of principal plus interest at a rate not fixed at the time of award but based on a specified index which is determinable in each applicable cost accounting period; e.g., a published corporate bond rate, such interest shall be included in the computation of the amount of future benefit. The interest rate to be used shall be the rate in effect at the close of the period in which the cost of deferred compensation is assignable. Since that interest rate is likely to vary from the actual rates in future periods, adjustments shall be made in any such future period in which the variation in rates materially affects the cost of deferred compensation.

(3) If the deferred compensation award provides for payment of principal plus interest at a rate not based on a specified index, or not determinable in each applicable year, the—

(i) Cost of deferred compensation for the principal of the award shall be measured by the present value of the future benefits of the principal, and shall be assigned to the cost accounting period in which the employer incurs an obligation to compensate the employee; and

(ii) Interest on such awards shall be assigned to the cost accounting period(s) in which the payment of the deferred compensation is made.

(4) If the terms of the award require that the employee perform future service in order to receive benefits, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost of deferred compensation for each cost accounting period shall be the present value of the future

benefits of the deferred compensation calculated as of the end of each such period to which such cost is assigned.

(5) In computing the present value of the future benefits, the discount rate shall be equal to the interest rate as determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 stat. 97 at the time the cost is assignable.

(6) If the award is made under a plan which requires irrevocable funding for payment to the employee in a future cost accounting period together with all interest earned thereon, the amount assignable to the period of award shall be the amount irrevocably funded.

(7) In computing the assignable cost for a cost accounting period, any forfeitures which reduce the employer's obligation for payment of deferred compensation shall be a reduction of contract costs in the period in which the forfeiture occurred. The amount of the reduction for a forfeiture shall be the amount of the award that was assigned to a prior period, plus interest compounded annually, using the same Treasury rate that was used as the discount rate at the time the cost was assigned. For irrevocably funded plans, pursuant to 9904.415-50(d)(6), the amount of the reduction for a forfeiture shall be the amount initially funded plus or minus a pro-rata share of the gains and losses of the fund.

(8) If the cost of deferred compensation for group plans measured in accordance with 9904.415-50(c) is determined to be greater than the amounts initially assigned because the forfeiture was overestimated, the additional cost shall be assignable to the cost accounting period in which such cost is ascertainable.

(e) The following provisions are applicable for plans, other than ESOPs, that meet the conditions of 9904.415-50(a) and the compensation is received by the employee in other than money. The measurements set forth in this paragraph constitute the present value of future benefits for awards made in other than money and, therefore, shall be deemed to be a reasonable measure of the amount of the future payment:

(1) If the award is made in the stock of the contractor, the cost of deferred compensation for such awards shall be

based on the market value of the stock on the measurement date; i.e., the first date the number of shares awarded is known. Market value is the current or prevailing price of the security as indicated by market quotations. If such values are unavailable or not appropriate (thin market, volatile price movements, etc.) and acceptable alternative is the fair value of the stock.

(2) If an award is made in the form of options to employees to purchase stock of the contractor, the cost of deferred compensation of such award shall be the amount by which the market value of the stock exceeds the option price multiplied by the number of shares awarded on the measurement date; i.e., the first date on which both the option price and the number of shares is known. If the option price on the measurement date is equal to or greater than the market value of the stock, no cost shall be deemed to have been incurred for contract costing purposes.

(3) If the terms of an award of stock or stock option require that the employee perform future service in order to receive the stock or to exercise the option, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost to be assigned shall be the value of the stock or stock option at the measurement date as prescribed in 9904.415-50(e)(1) or (e)(2).

(4) If an award is made in the form of an asset other than cash, the cost of deferred compensation for such award shall be based on the market value of the asset at the time the award is made. If a market value is not available, the fair value of the asset shall be used.

(5) If the terms of an award, made in the form of an asset other than cash, require that the employee perform future service in order to receive the asset, the cost of the deferred compensation shall be appropriately assigned to the periods of current and future service based on the facts and circumstances of the award. The cost to be assigned shall be the value of the asset at the time of award as prescribed in 9904.415-50(e)(4).

(6) In computing the assignable cost for a cost accounting period, any forfeitures which reduce the employer's obligation for payment of deferred compensation shall be a reduction of contract costs in the period in which the forfeiture occurred. The amount of the reduction shall be equal to the amount of the award that was assigned to a prior period, plus interest compounded annually, using the Treasury rate (see 9904.415-50(d)(5)) that was in effect at the time the cost was assigned. If the recipient of the award of stock options voluntarily fails to exercise such options, such failure shall not constitute a forfeiture under provisions of this Standard.

(7) Stock option awards or any other form of stock purchase plans containing all of the following characteristics shall be considered noncompensatory and not covered by this Standard:

(i) Substantially all full-time employees meeting limited employment qualifications may participate.

(ii) Stock is offered equally to eligible employees or based on a uniform percentage of salary or wages.

(iii) An option or a purchase right must be exercisable within a reasonable period.

(iv) The discount from the market price of the stock is no greater than would be reasonable in an offer of stock to stockholders or others.

(f)(1) For an ESOP, the contractor's cost shall be measured by the contractor's contribution, including interest and dividends if applicable, to the ESOP. The measurement of contributions made in the form of stock of the corporation or property, shall be based on the market value of the stock or property at the time the contributions are made. If the market value is not available, then fair value of the stock or property shall be used.

(2) A contractor's contribution to an ESOP shall be assignable to a cost accounting period only to the extent that the stock, cash, or any combination thereof resulting from the contribution is awarded to employees and allocated to individual employee accounts by the tax filing date for that period, including any permissible extensions thereof. All stock or cash that is allocated to

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the individual employee accounts between the end of the cost accounting period and the tax filing date for that period must be assigned to the cost accounting period in which the employee is awarded the stock or cash. Any portion of the stock or cash resulting from a contractor's contribution that is not awarded to employees or allocated to individual employee accounts by the tax filing date for that period, including any permissible extensions thereof, shall be assigned to a future cost accounting period or periods when the remaining portion of stock or cash has been awarded to employees and allocated to individual employee accounts. This stock shall retain the value established when it was originally purchased by or otherwise made available to the ESOP.

[57 FR 14153, Apr. 17, 1992, as amended at 73 FR 23965, May 1, 2008]

9904.415-60 Illustrations.

(a) Contractor A has a deferred compensation plan in which all cash awards are increased each year by an interest factor equivalent to the long-term borrowing rate of the contractor prevailing during each such year. The interest factor based on a variable long-term borrowing rate meets the criteria of 9904.415-50(d)(2). Consequently, the cost of deferred compensation for Contractor A shall be measured by the present value of the future benefits and shall be assigned to the cost accounting period in which the contractor initially incurs an obligation to compensate the employee. If the long-term borrowing rate for Contractor A was 9 percent at the close of the period to which the cost of deferred compensation was assignable, then that rate should be used to calculate the future benefit. Any adjustment in the cost of deferred compensation which results from a material change in the 9 percent rate in future applicable periods shall be made in each such future period or periods (see 9904.415-50(d)(2)).

(b) Contractor B made a deferred compensation award of \$10,000 to an employee on December 31, 1976, for services performed in 1976 to be paid in equal annual payments of \$2,000 starting at December 31, 1981. The terms of

the award do not provide for an interest factor to be included in the payment; consequently, according to provisions of 9904.415-50(d)(1), interest may not be included in the computation of the future benefits. The assignable cost for 1976 is computed as follows, assuming that the interest rate determined by the Secretary of the Treasury (pursuant to Public Law 92-41), 85 Stat. 97 at the time of the award is 8 percent and the conditions set forth in 9904.415-50(a) are met.

Year	Amount of future payment × discount rate 8-percent present value factor=present value
1981	\$2,000×0.6805=\$1,361
1982	2,000×.6301=1,260
1983	2,000×.5834=1,167
1984	2,000×.5402=1,080
1985	2,000×.5002=1,000
Assignable cost for 1976	5,868

(c) Contractor C awarded stock options for 1,000 shares of the contractor to key employees on December 31, 1976, under a deferred compensation plan requiring 2 years of additional service before the awards can be exercised. The facts and circumstances of the awards indicate that the deferred compensation applies only to the periods of future service. The market price of the stock was \$26 per share, the option price was \$22, and the interest rate established by the Secretary of the Treasury in effect at the time of award was 8 percent.

(1) In accordance with 9904.415-50(e)(2), the cost of the stock options is the amount by which the current value of the stock exceeds the option price multiplied by the number of shares awarded on the measurement date. Thus, the total cost of the stock options is 1,000 shares multiplied by the difference of the option price and the market price (\$26-22) or \$4,000.

(2) Under provisions of 9904.415-50(e)(3), the cost for stock options is assigned to each future cost accounting period in which employee service is required and is computed as follows:

	<i>Assign- able cost</i> ¹
Year of required service:	
1977	\$2,000